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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)	
	)	
Review of the Commission's Regulations Governing Attribution of Broadcast Interests	)	MM Docket No. 94-150
	)	
Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry	)	MM Docket No. 92-51
	)	
Reexamination of the Commission's Cross-Interest Policy	)	MM Docket No. 87-154

COMMENTS OF FREEMAN SPOGLI & CO., INCORPORATED

John E. Welch

O'MELVENY & MYERS
555 13th Street, N.W.
Washington, D.C. 20004-1109

Counsel for Freeman Spogli & Co., Incorporated

Dated: May 17, 1995

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To: The Commission

SUMMARY OF COMMENTS OF FREEMAN SPOGLI & CO., INCORPORATED

Freeman Spogli & Co., Incorporated ("Freeman Spogli") supports the Commission's review of its broadcast media attribution rules, cross-interest policy and other regulations and policies affecting investment in the broadcast industry. As a leading private investment firm that manages non-publicly traded limited partnerships whose limited partners generally are institutional investors ("investment partnerships"), Freeman Spogli frequently has been dissuaded from making investments in broadcast

media and other FCC-regulated enterprises because of the obstacles posed by the Commission's attribution regulations and policies relating to limited partnership interests. Moreover, other investment partnerships have encountered similar obstacles. Accordingly, Freeman Spogli urges the Commission to:

> (i) Adopt an equity ownership benchmark of 20% for limited partners in investment partnerships, which are defined as limited partnerships with at least $25 million in assets; and
>
> (ii) Retain as a mechanism for achieving non-attribution for limited partners who cannot qualify for the foregoing 20% equity benchmark exemption the "insulation criteria" that have been in place since the mid-1980's, but modify those criteria to remove substantial ambiguities that have created confusion on the part of investors and taxed the resources of the Commission's staff.

Adoption of these changes in the Commission's limited partnership attribution regulations and policies will reduce administrative costs for both investors and the Commission and otherwise remove serious impediments to attracting substantial amounts of additional equity and other financing for the broadcast industry. Freeman Spogli believes that this highly desirable result can be obtained without subverting or in any way compromising the Commission's policies underlying its limited partnership attribution rules.

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To: The Commission

COMMENTS OF FREEMAN SPOGLI & CO., INCORPORATED

Freeman Spogli & Co., Inc. ("Freeman Spogli"), by its counsel, submits these comments in response to the Commission's Notice of Proposed Rule Making[1] (the "1995 NPRM") in the above-captioned proceedings.

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[1] *Notice of Proposed Rule Making*, MM Docket Nos. 94-150, 92-51 and 87-154 (released January 12, 1995); *see also Order Granting Extension of Time for Filing Comments*, MM Docket Nos. 91-221, 87-8, 94-149 and 91-140, 94-150, 92-51 and 87-154 (extending comment deadline to May 17, 1995).

The Commission stated a critical objective in connection with the 1995 NPRM by recognizing that it

> "must tailor the attribution rules to permit arrangements in which a particular ownership or positional interest involves minimal risk of influence, in order to avoid unduly restricting the means by which investment capital may be made available to the broadcast industry."[2]

As a leading private investment firm managing non-publicly traded limited partnerships that invest hundreds of millions of dollars of capital on behalf of their primarily institutional limited partners ("investment partnerships"), Freeman Spogli hereby requests that the Commission honor the foregoing objective by revising its attribution regulations and policies relating to limited partnership interests to remove the costly and cumbersome obstacles they place in the paths of investment partnerships. Specifically, Freeman Spogli urges the Commission to modify its limited partnership attribution criteria by:

> (i) Adopting an equity ownership benchmark of 20% for limited partners in investment partnerships, which are defined as partnerships with at least $25 million in assets; and
>
> (ii) Retaining as a mechanism for ensuring non-attribution for limited partners who cannot qualify for the 20% equity benchmark exemption the "insulation criteria" that have been in place since the mid-1980's, but modifying those criteria to remove substantial ambiguities that have created confusion on the part of investors and taxed the resources of the Commission's staff.

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[2] 1995 NPRM at ¶ 5.

BACKGROUND

A. Freeman Spogli

Freeman Spogli is a private investment firm devoted exclusively to private equity investing. Principally through limited partnerships in which Freeman Spogli or its affiliates act as the general partner, Freeman Spogli has invested hundreds of millions of dollars in a diverse group of companies. For example, in 1994, Freeman Spogli raised $580 million through a new Delaware limited partnership in which an affiliate of Freeman Spogli is the general partner and private and public pension funds, insurance companies and commercial banks constitute most of the limited partners. Freeman Spogli invests the funds of this limited partnership principally in privately negotiated equity and other securities in connection with corporate acquisitions organized by Freeman Spogli and other circumstances where an infusion of capital together with assistance to management by Freeman Spogli's investment partnership is expected to generate appropriate returns on investment. As with a typical investment partnership, the general partner of this partnership makes investment decisions and manages the partnership. The limited partners, who are essentially passive investors who view the investment partnership as an investment vehicle that is able to provide returns substantially in excess of publicly traded investment funds (*e.g.*, mutual funds), do not participate in the management of the partnership or its investments.

B. Investment Partnerships: Important Sources of Capital

The type of limited partnership investment entity that Freeman Spogli organizes and manages (*i.e.*, limited partnerships referred to in these Comments as "investment partnerships") is an attractive investment vehicle for hundreds of public and private pension funds, universities and other institutions of higher education, insurance companies and commercial banks. We have encountered investment partnerships ranging in size from less than $30 million in assets available for investment to over $1 billion. Because most of them are private entities (*i.e.*, not required to register under the Securities Exchange Act of 1934 or the Investment Company Act of 1940), however, there is not a ready source of information on investment partnerships that would allow us to provide the Commission with precise empirical data on such investment vehicles and the amount of capital they could make available to the broadcast industry or other segments of the communications industry in general.

A report prepared by the Investment Program Association[3] (the "IPA Report"), which has updated an earlier analysis of certain investment partnerships by Townsend-Greenspan & Company,[4] an economic consulting firm (the "Townsend-Greenspan Study"), provides some data on the importance of all types of limited partnerships in the U.S. economy. This report notes that in 1988, the total assets of all limited partnerships in the U.S. was $843 billion,[5] and "finance partnerships" controlled

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[3] *Partnerships in America*, 1991 Update, Investment Program Association (1991). The data on which this report is based is derived from IRS tax reports.

[4] *Partnerships in America*, Townsend-Greenspan & Company (1987).

[5] IPA Report, p. 2.

24% of all limited partnership assets in 1988.[6] And, although the data is somewhat dated, the importance of limited partnerships is indicated by the following observations regarding the Townsend-Greenspan Study:

> "The Townsend-Greenspan study also demonstrated the key role played by partnerships in the dynamic expansion of the American economy. During 1984-1986 their net fixed capital stock expanded three to four times as fast as the general business sector capital stock. Limited partnerships, and especially large limited partnerships, also raised much more new equity capital during this period than was raised by initial public stock offerings of corporations."[7]

While we recognize that the foregoing data on all types of limited partnerships is not sufficiently specific to establish the precise level of capital that may be made available by investment partnerships to broadcasters and other segments of the communications industry, it nevertheless suggests that tens of billions of dollars are being invested through limited partnership vehicles. Accordingly, if the Commission's attribution regulations and policies applicable to limited partnerships are functioning as impediments to such partnerships' investing in the communications industry, literally billions of dollars of capital is at risk.

EXISTING LIMITED PARTNERSHIP ATTRIBUTION RULES: PROBLEMS

A. Some Investment Partnerships Cannot Satisfy the Insulation Criteria

The Commission's attribution regulations and policies governing limited partnership interests relating to broadcast licensees provide that a limited partner will be

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[6] *Id.* at p. 5.

[7] *Id.* at p. 2.

attributed with the partnership's interest with respect to a licensee unless the limited partner is

> "sufficiently insulated from 'material involvement,' directly or indirectly, in the management or operation of the partnership's media related activities, upon a certification by the licensee that the limited partners comply with specified insulation criteria."[8]

These limited partnership attribution rules are set forth at 47 C.F.R. § 73.3555, Note 2(g)(2).[9] The insulation criteria that must be included in the limited partnership agreement or certificate of limited partnership in order to permit the licensee to make the non-attribution certification are listed at Note 110 in the 1995 NPRM.[10]

A major problem posed by the insulation criteria is simply that they include requirements that some investment partnerships either cannot satisfy, or that dissuade certain institutional investors from becoming limited partners of investment partnerships in the first instance. In either case, substantial investment capital that otherwise might be available to the broadcast industry is thereby lost.

The troublesome criteria that pose difficulties for widely held limited partnerships are addressed in the Commission's Notice of Proposed Rule Making and

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[8] 1995 NPRM at ¶ 55.

[9] The same limited partnership attribution regulations and insulation criteria are applicable to the Commission's broadcast television - cable television cross-ownership rule. *See* 47 C.F.R. § 76.501, Note 2(g).

[10] The insulation criteria are discussed in detail in the *Memorandum Opinion and Order* in MM Docket No. 83-46, 58 RR 2d 604 (1985) (the "Attribution Reconsideration Opinion"), *further recon. granted in part, Memorandum Opinion and Order* in MM Docket No. 83-46, 1 FCC Rcd 802 (1986) (the "Attribution Further Reconsideration Opinion;" collectively with the Attribution Reconsideration Opinion, the "Attribution Reconsideration Opinions").

Notice of Inquiry in MM Docket No. 92-51, 7 FCC Rcd 2654 (1992) (the "Capital Formation Notice"), two petitions for declaratory rulings filed by Kagan Media Partners and Equitable Capital Management Corporation in 1990[11] and ¶¶ 58-59 of the 1995 NPRM (including the comments filed in response to the Capital Formation Notice, as referenced in ¶ 59 of the 1995 NPRM). The Commission would be making a grave mistake, however, if it were to provide relief from some or all of the insulation criteria solely for widely held limited partnerships -- which might include only publicly traded partnerships or those with a very large number of limited partners. Many investment partnerships have fewer than 50 limited partners -- yet they, too, face problems caused by the insulation criteria.

For example, some institutional investors object to the insulation criterion requiring that a

> "limited partner may not vote to remove a general partner except where the general partner is subject to bankruptcy proceedings, is adjudicated incompetent by a court of competent jurisdiction or is removed for cause as determined by a neutral arbiter."[12]

They believe that this requirement unduly constrains the limited partners, who frequently owe fiduciary duties to other persons (*e.g.*, pension fund trustees and other fiduciaries).

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[11] *See Kagan Media Partners and Equitable Capital Management Corporation Petitions for Declaratory Ruling Concerning Insulation of Limited Partners of Business Development Companies* (MMB File No. 900924A), *FCC Daily Digest*, Public Notice, DA 90-1098 (Aug. 17, 1990).

[12] 1995 NPRM, n. 110.

B. Certain of the Insulation Criteria are Unacceptably Ambiguous

Other problems result from the ambiguity inherent in the insulation criteria. Although the Commission admirably intended to provide the broadcast industry with a road map that would be a model of clarity when it adopted the insulation criteria in the mid-1980's,[13] a decade of experience demonstrates that the road map is in fact more like an unreliable compass. The Commission itself recognized the vagueness inherent in the insulation criteria by making the following declaration at ¶ 46 of the Attribution Reconsideration Opinion:

> "We also wish to make clear that these guidelines are not incorporated into our rules and serve only to indicate the type of insulation the Commission will consider in evaluating challenges to the exclusion."

Nevertheless, in the same discussion in the Attribution Reconsideration Opinion (¶ 50) the Commission concluded that

> "inclusion of the above restrictions [*i.e.*, the specific insulation criteria] in the limited partnership agreement, coupled with proper consideration of close familial relationships, provide sufficient insulation to permit the licensee or cable television system to certify that the limited partner could not be involved in any material respect in the management or operation of the business."

The former statement by the Commission suggests that the guidelines cannot necessarily be viewed as a safe harbor, even though the typical limited partnership agreement that purports to provide insulation for limited partners religiously incorporates (frequently

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[13] In ¶ 44 of the Attribution Reconsideration Opinion, the Commission observed that

> "[n]ot only will our guidelines provide greater certainty, but they will also lessen the need for the Commission to make costly ad hoc administrative determinations regarding the adequacy of specific insulating mechanisms."

verbatim) the specific insulation criteria adopted by the Commission in the Attribution Reconsideration Opinions.

A practical illustration of the ambiguity inherent in the insulation criteria concerns voting rights of limited partners. While ¶ 49 of the Attribution Reconsideration Opinion and the provisions of the Attribution Further Reconsideration Opinion require that the partnership agreement limit the voting rights of limited partners seeking non-attribution ("exempt limited partners") in certain respects regarding the admission and removal of general partners, the Attribution Reconsideration Opinions do not elaborate on any additional restrictions on voting rights for exempt limited partners. Our experience with the staff of the Mass Media Bureau, however, suggests that even though a limited partnership agreement contains all of the specified insulation criteria, the staff views certain voting rights accorded to limited partners as destroying their exempt status because the exercise of such voting rights would cause an exempt limited partner to run afoul of the Commission's proscription in Note 67 to the Attribution Reconsideration Order. Note 67 provides that:

> "If a limited partner relieved from attribution subsequently acts in a manner which contravenes the insulating provisions of the partnership agreement or the certificate of limited partnership, or if that partner subsequently becomes materially involved in the management or operations of the partnership, the Commission will attribute the limited partnership interest of the nonconforming partner."

Presumably, then, an otherwise exempt limited partner's exercise of voting rights with respect to a matter that the Commission views as being too closely involved with the management or operations of the media enterprise of the limited partnership would result in that limited partner having an attributable interest in a broadcast licensee or

cable system to the full extent of the partnership's attributable interest in such licensee or system.

A specific example of a voting powers issue arises in the context of major asset acquisitions and dispositions. Limited partners sometimes wish to have the right to vote not only on the sale of all or substantially all of the partnership's assets, but also on other significant asset dispositions or acquisitions that involve transactions having nothing to do with the day-to-day operations of the media business of the partnership. Unfortunately, whether the inclusion of such voting rights violates the insulation criteria is not expressly addressed by the Attribution Reconsideration Opinions. The Commission's commentary in the first paragraph of Note 72 of the Attribution Reconsideration Order states that "[t]here are a number of powers which a limited partner may exercise consistent with these guidelines [*i.e.*, the insulation criteria]." Note 72 then declares that:

> "[An exempt limited partner] may vote on the sale, exchange, lease, mortgage, pledge or other transfer of all or substantially all of the assets of the business other than in the ordinary course of the business."

The foregoing statement merely provides an example of voting powers consistent with the insulation criteria. While it does not specifically declare that limited partners may vote on the disposition of less than "substantially all of the assets" of the media business provided that such a transaction would not be in the ordinary course of business, it certainly does not proscribe such a vote. Nevertheless, the staff of the Mass Media Bureau has suggested on an informal basis that a limited partner who votes on the sale of anything less than substantially all of the assets of a media business will lose its exempt status. If this position were adopted, voting on a disposition of significant

assets of a large media enterprise that might involve tens of millions of dollars would nevertheless be deemed to involve the limited partner in the operation and management of the business to an unacceptable extent. Surely the Commission did not intend to prohibit limited partners from exercising voting rights with respect to such major events that clearly are not part of the day-to-day operations of a media enterprise. The Commission, however, has not provided clear guidance to either the staff or the public on this important issue.[14]

The voting powers problem is only one example of the ambiguity that is encountered when the insulation criteria are applied to limited partnerships investing in media enterprises. The comments filed by The Prudential Insurance Company of America on June 12, 1992 (the "Prudential Comments") in response to the Capital Formation Notice provide another example relating to the insulation criterion prohibiting the limited partners from voting to remove a general partner

> "except where the general partner is subject to bankruptcy proceedings, is adjudicated incompetent by a court of competent jurisdiction or is removed for cause as determined by a neutral arbiter."[15]

Prudential observes at page 13 of its comments that

> "it is unclear whether the right to remove a general partner permissibly extends to any event constituting "cause" under the partnership agreement

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[14] The Joint Comments submitted by A.H. Belo Corporation, Broad Street Television, Communications Equity Associates, Cosmos Broadcasting Corporation, Falcon Cable Systems Company, Jones Intercable, Inc., Multimedia, Inc. and River City Broadcasting on June 12, 1992 (the "Joint Comments") in connection with the Commission's Capital Formation Notice also emphasize the lack of clarity in this area. *See* p. 15 of the Joint Comments.

[15] 1995 NPRM, n. 110.

and/or state law, or solely to the exceptionally limited instances of 'malfeasance, criminal conduct or wanton or willful neglect'."

While the example offered by Prudential relates to the interpretation of a specific insulation criterion, much of the need for clarification concerns the types of activities in which limited partners may participate without becoming materially involved in the media business of the partnership (*e.g.*, as discussed above, voting on a disposition or acquisition of less than substantially all of the assets of the partnership). In any event, the examples of the inherent ambiguity in the application of the insulation criteria cited above are only the tip of the iceberg.

C. Compliance with the Limited Partnership Attribution Rules is Costly for the Broadcast Industry, the Commission, Investment Partnerships and their Limited Partners

The ambiguities inherent in the insulation criteria cause both media enterprises and investment partnerships to incur significant legal and related compliance expenses. Frequent inquiries directed to the staff of the Mass Media Bureau also impose onerous burdens on the limited resources of the Commission. Additionally, when questions about the application of the insulation criteria with respect to a particular investment cannot be resolved in a satisfactory manner, investment partnerships frequently decline to make the investment. The withholding of such substantial investment capital from the broadcast industry imposes an even greater cost than the administrative expenses noted above.

Moreover, the insulation criteria are not the only source of these costs. Although the 1995 NPRM focuses on attribution criteria for the broadcast industry, the Commission should be aware that investment partnerships incur substantial compliance

costs because the Commission's various Bureaus do not administer uniform limited partnership interest attribution regulations and policies. For example, the attribution rules used by the Commission to apply its restrictions on cross-ownership of a cable television system and a wireless cable (MDS/MMDS) or SMATV system apply a straight 5% equity benchmark rather than the Mass Media Bureau's insulation criteria.[16] Accordingly, the typical investment partnership that provides capital to the broadcast, cable and wireless television segments of the communications industry not only must ensure that its limited partners meet the Mass Media Bureau's insulation criteria, but also needs to solicit compliance information on a regular basis from numerous limited partners and certain of their affiliates for purposes of the foregoing equity benchmark regulations. And, considering that many of the limited partners are institutional investors that may hold small minority interests in multiple media properties through other investment partnerships,[17] this also imposes a significant administrative burden on these limited partners.

THE COMMISSION SHOULD ADOPT AN EQUITY BENCHMARK STANDARD FOR INVESTMENT PARTNERSHIPS

The insulation criteria, which seek to prevent limited partners from becoming materially involved in the management and operation of a media business, are

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[16] 47 C.F.R. § 21.912, Note 1 (1994).

[17] The nation's largest private and public pension funds frequently are limited partners in multiple investment partnerships. As passive investors with minority interests in such partnerships, they are subjected to significant administrative burdens particularly in situations where the Commission's attribution rules provide for low equity benchmarks (*e.g.*, 5%).

designed more for smaller partnerships that function as operating companies (*i.e.*, licensees) or their immediate holding companies, than for large investment partnerships whose limited partners are principally institutional investors. While Freeman Spogli does not wish to suggest that the Commission eliminate the insulation criteria, it does strongly recommend that the Commission adopt an alternative attribution regime based on equity benchmarks that would be available only to large investment partnerships and similar entities that function principally as investment vehicles for public and private pension funds, institutional and other generally passive investors. In doing so, it is critical that the Commission recognize that the limited partnership attribution rules should not be amended on the basis of whether the partnership is publicly traded or otherwise widely held. Such an approach would provide no relief whatsoever to limited partnerships with relatively few limited partners (*e.g.*, under 50 institutional or other sophisticated limited partners) which nevertheless collectively serve as investment vehicles for literally billions of dollars of capital.

Specifically, the Commission should exempt from attribution all limited partnership interests (whether or not insulated) in limited partnerships with at least $25 million in assets that are below 20% of the total equity of the partnership. This proposal is somewhat similar to that suggested in the Prudential Comments, although more conservative in that it is limited to partnerships with assets so substantial that they

typically will be investment partnerships whose limited partners frequently will be public and private pension funds, institutional investors and other generally passive investors.[18]

An equity benchmark would be appropriate because, based on Freeman Spogli's experience, limited partners in investment partnerships typically wield less influence than minority shareholders in closely held corporations with comparable equity interests. The following remarks at page 12 of the Prudential Comments also are instructive on this point:

> "Prior rationales for treating limited partnerships distinct from corporations for purposes of measuring the degree of influence or participation do not reflect commercial or legal realities. In Prudential's experience, and as generally reflected under state partnership law, there is no material difference in the participation and/or voting power of a 20% limited partnership interest and a 20% voting stock interest. Moreover, such observations hold whether or not the partnership interests or the stock is widely or closely held."

Also, the equity benchmark standard will eliminate the need for investment partnerships to suffer the uncertainties and ambiguities inherent in the insulation criteria. Administrative and other costs, both for regulated entities and the Commission, will thereby be reduced.

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[18] If the Commission is not satisfied that the $25 million threshold is high enough to exclude limited partners in non-investment partnerships (which will still be able to achieve non-attribution by complying with the insulation criteria), it might provide a two-tiered benchmark for limited partners in such qualifying partnerships. Under the latter approach, limited partners who do not qualify as "institutional" might be subject to a 10% benchmark. If the Commission decides to adopt this approach, Freeman Spogli would be pleased to provide additional comments on an appropriate definition of "institutional investor." (In this regard, several of the criteria set forth at page 10 of the Joint Comments are helpful.) Raising the $25 million threshold, however, would be counterproductive because such a threshold would exclude many investment partnerships organized separately for foreign limited partners that frequently co-invest with larger investment partnerships organized by the same general partner.

The Commission also should apply the foregoing equity benchmark regime for investment partnerships across-the-board to all attribution rules administered by all Bureaus. While Freeman Spogli recognizes that the 1995 NPRM principally solicits comments relating to attribution rules in the broadcast industry, supplementing the current balkanized collection of broadcast, wireless cable/SMATV, PCS, cellular and video dialtone attribution rules applicable to limited partnerships with uniform equity benchmark attribution rules for investment partnerships will reduce regulatory barriers to investment capital in all industries regulated by the Commission.

THE COMMISSION SHOULD CLARIFY THE INSULATION CRITERIA

The insulation criteria should remain as a means to avoid attribution of limited partnership interests for limited partners in investment partnerships whose equity interests are not less than 20%, and as the sole means of avoiding such attribution for limited partners in all other limited partnerships (which would not qualify for the equity benchmark exemption because they would not be "investment partnerships"). They should be clarified, however, to remove the inherent ambiguities noted above and to respond to additional problems that undoubtedly will be raised by other commenters in these proceedings.

In particular, Freeman Spogli encourages the Commission to recognize that limited partners may vote on the disposition or acquisition of less than substantially all of the assets of a media enterprise without becoming materially involved with the management or operations of the business. Significant asset dispositions or acquisitions

are by definition events that are not part of the day-to-day operations of a media enterprise. Voting on such extraordinary matters certainly would not materially involve limited partners in the management of the programming, personnel or finances of the media enterprise. The critical question, however, is what constitutes a "significant" asset disposition or acquisition. Although any threshold that might be proposed is inherently arbitrary, Freeman Spogli believes that as long as the disposition or acquisition involves not less than 10% of the assets of the media enterprise, limited partners should be permitted to vote on it without losing their exempt status.

CONCLUSION

Freeman Spogli applauds the Commission's review of its broadcast media attribution rules and appreciates this opportunity to remind the Commission of the importance of investment partnerships as a source of capital for the broadcast industry and other segments of the communications industry. By adopting the alternative 20% equity benchmark for investment partnerships and clarifying its insulation criteria as suggested above, the Commission will be able to realize its stated objective to "avoid unduly restricting the means by which investment capital may be made available to the broadcast industry." Although the current insulation criteria do in fact significantly restrict the supply of investment capital from investment partnerships, the proposed changes to the Commission's attribution rules will remove untenable regulatory shackles

without compromising the integrity of the Commission's attribution rules applicable to limited partnerships.

Respectfully submitted,

FREEMAN SPOGLI & CO., INCORPORATED

By 

John E. Welch
O'MELVENY & MYERS
555 13th Street, N.W.
Washington, D.C. 20004-1109
(202) 383-5376

Its Counsel

Dated: May 17, 1995